



The State of the Economy and Prospects for Tax Revenue in Tennessee

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by
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The State of the Economy and Prospects for Tax Revenue in Tennessee

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The Balance of News

U.S. Growth Is Expected to Continue into 2006 and Beyond, But Several Trouble Sports Bear Watching

U.S. posting strong economic growth

- Growth should be around 3.6 percent this year, barely beneath the 3.8 percent for 2004

Policy is less accommodative of growth

- Removal of liquidity is expected to continue into next year
- Debate now surfacing over extent of future rate increases

Global growth is mixed

- China's growth remains strong
- Japan's economic recovery could be affected by the dollar
- European growth remains weak

International tensions remain

- U.S. current account deficit remains very large
- Talk of possible diversification of assets by foreign central banks, but possibility is now more remote with the dollar appreciating

Domestic issues are also developing

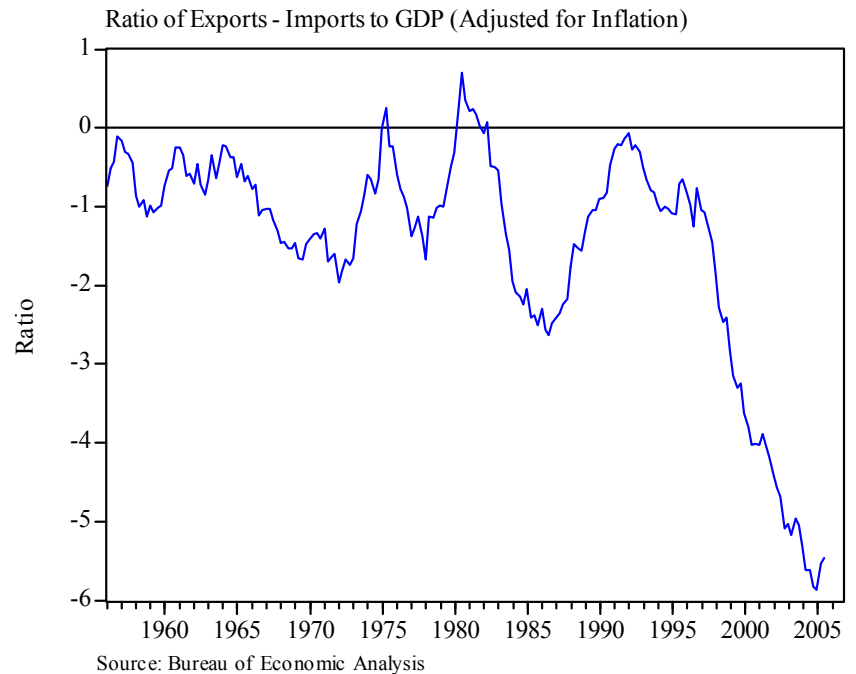
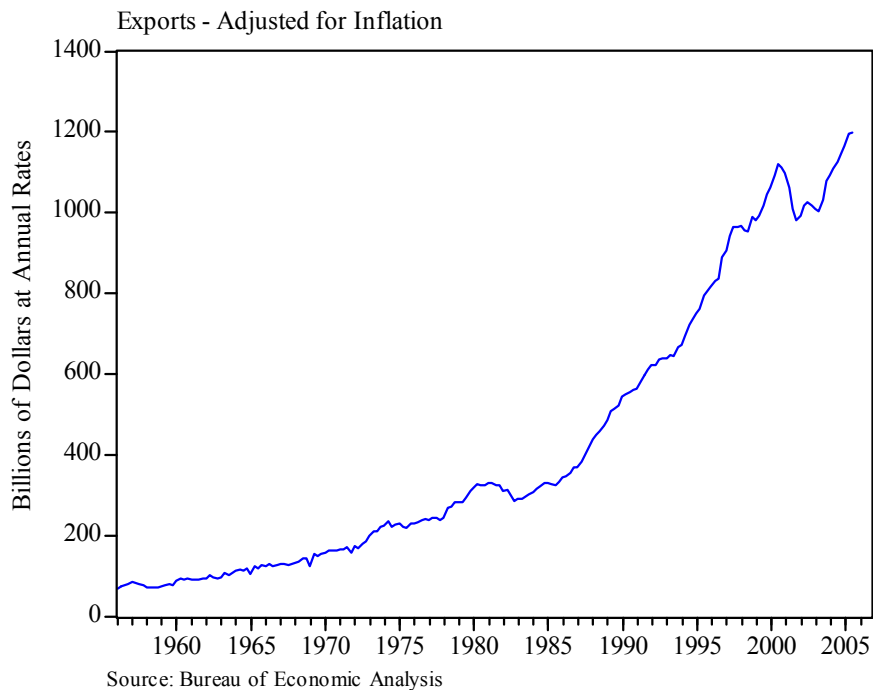
- Consumer confidence has faltered
- Leading indicators faltered but rebounded
- Equity market shows little upside movement
 - But bond market exhibited little deterioration in price over 2005
- Deflation in goods-producing is not as threatening as two years ago, but price declines have recently been registered in CPI goods component excluding food and energy
- Housing resembles a bubble to some
- Vehicle sales are already showing strains of higher energy prices

Domestic stress points are now evident

- Strong employment gains now possible without share drop in unemployment rate
- Saving rate is troublingly low
- Labor shedding continues, and initial unemployment claims remain comparatively high

The U.S. Cycle in Perspective

The U.S. in the Global Economy



The U.S. Business Cycle in Perspective

Recovery in Technology Spending Still Dominates the Investment Spending Picture

Business equipment and software

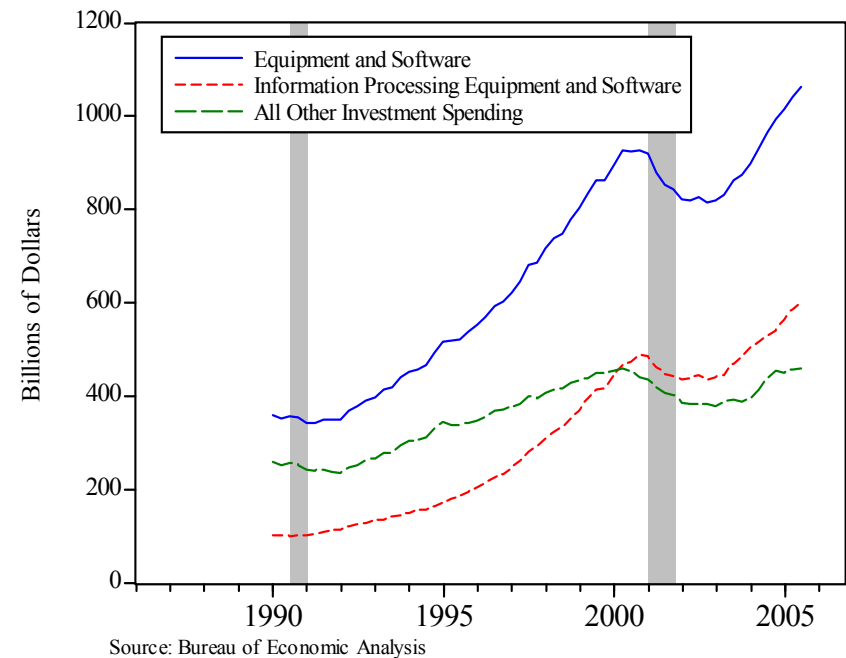
- Nearly 60 percent of total is devoted to information-processing equipment
- Remainder is spread among industrial, transportation, and other equipment

Upturn in technology spending led the upturn in general investment spending throughout this expansion

The upturn in technology spending is likely behind the big productivity gains in the current national economic recovery

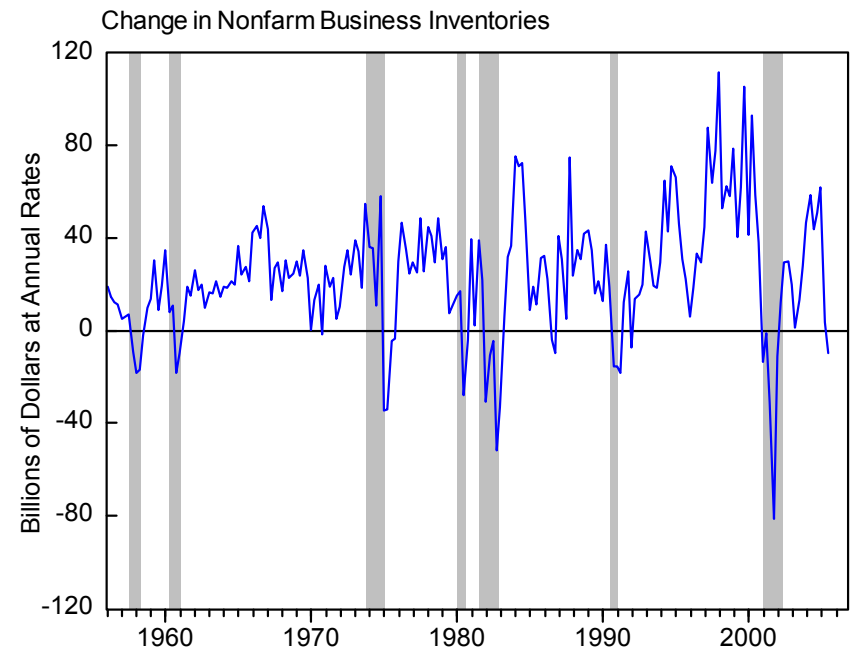
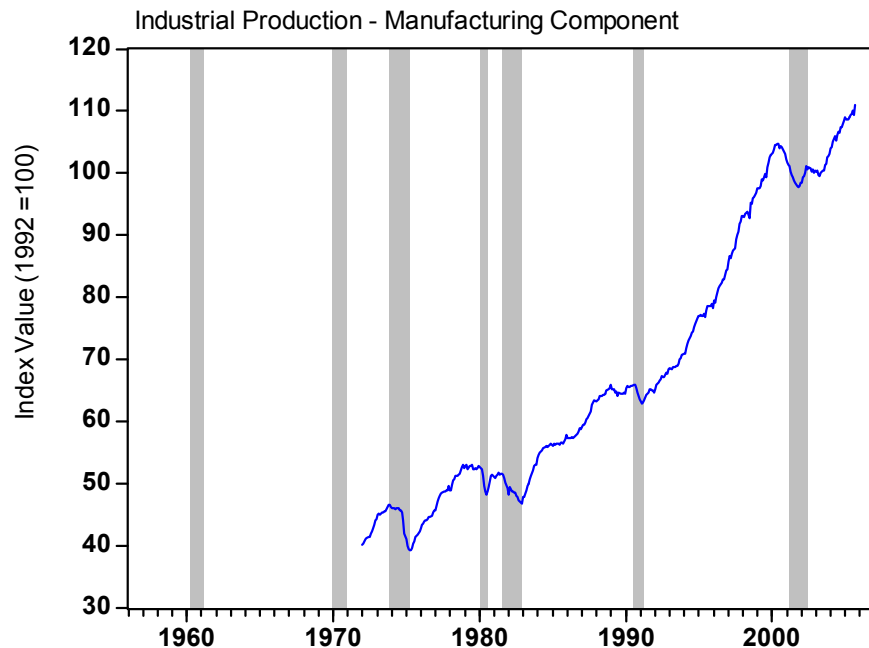
While increasing, spending on general investment goods has barely reached its last cyclical peak

This reflects excess capacity in the manufacturing sector (less than 79 percent in October 2005) and ongoing uncertainty surrounding prospects for profit growth



The U.S. Cycle in Perspective

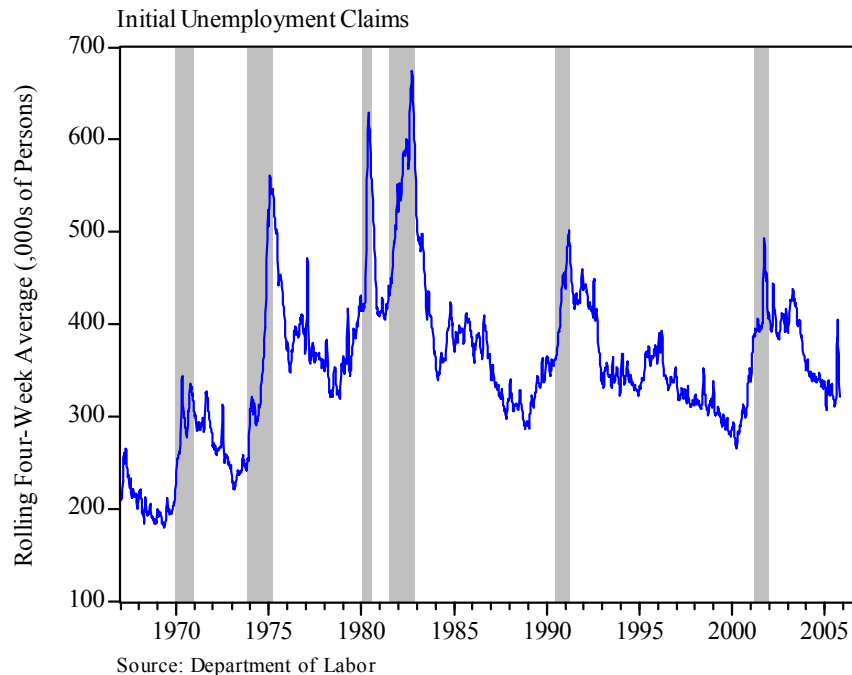
Industrial Output and Changes in Inventories



Source: Bureau of Economic Analysis

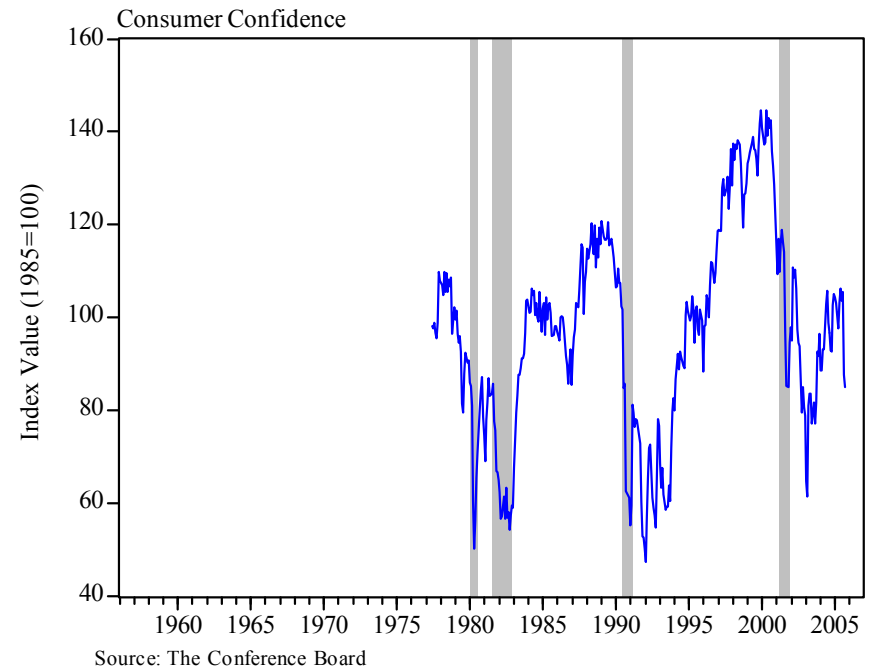
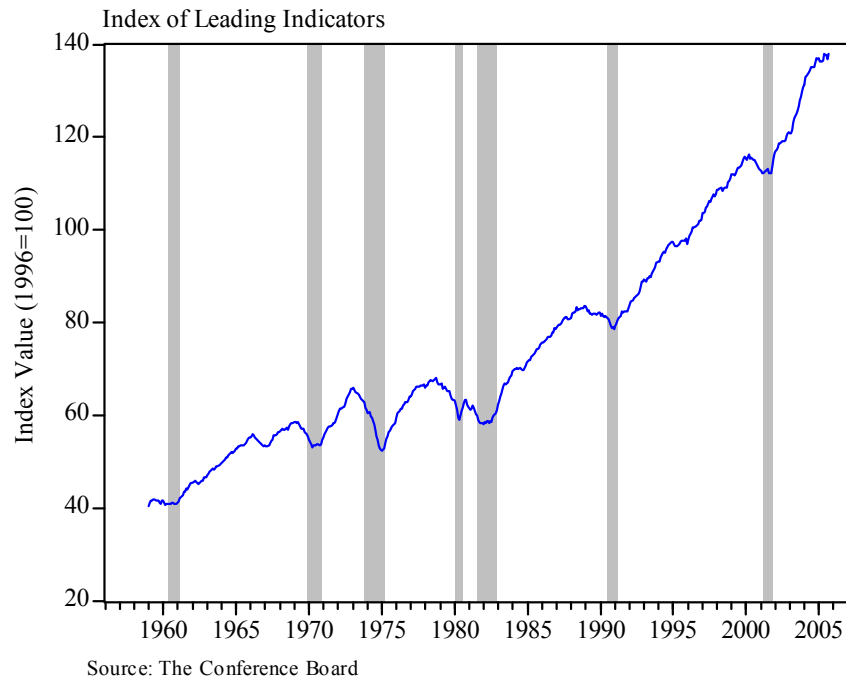
The U.S. Cycle in Perspective

Labor Markets: Initial Unemployment Claims and the Duration of Unemployment



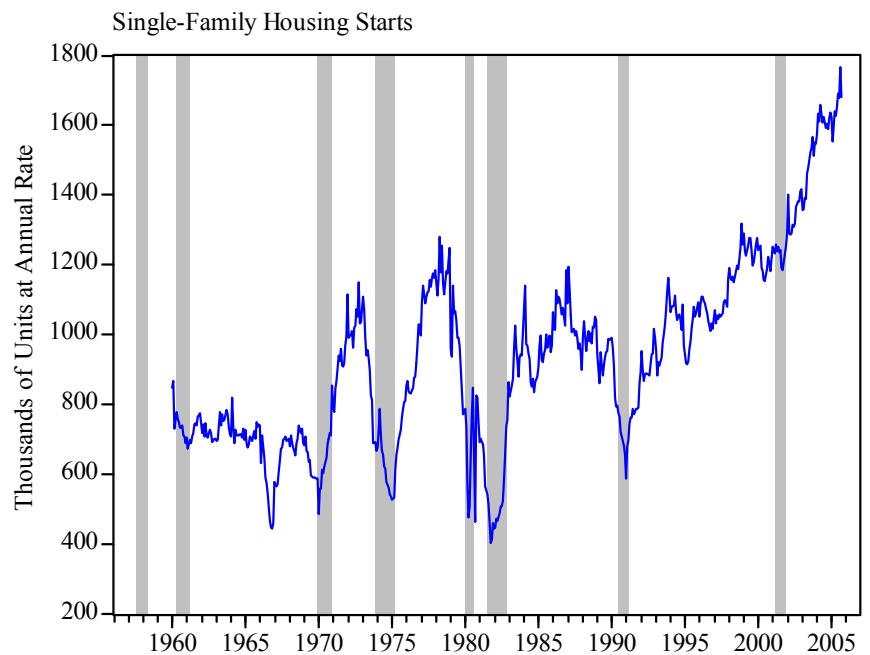
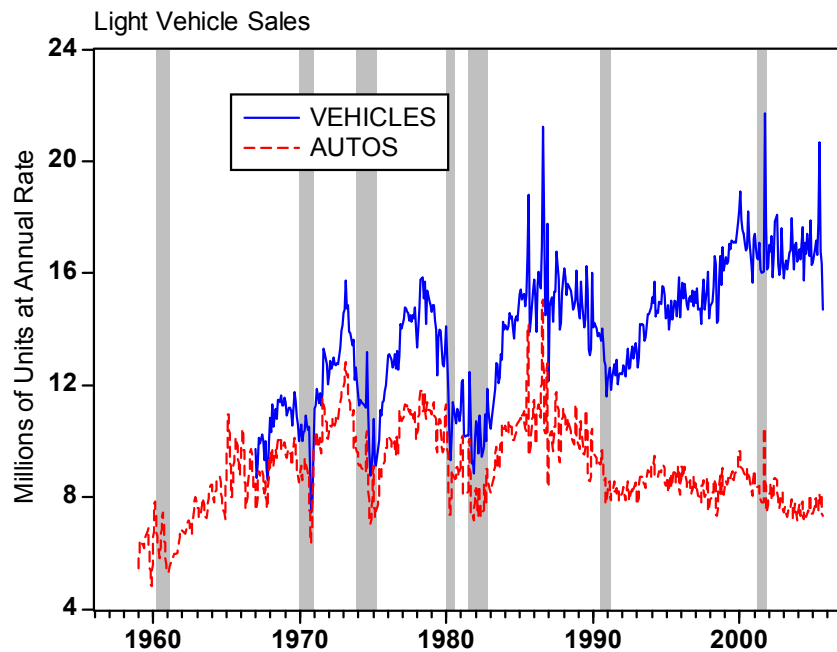
The U.S. Cycle in Perspective

Leading Indicators and Consumer Confidence



The U.S. Cycle in Perspective

Light Vehicle Sales and Housing



Source: Bureau of the Census

The U.S. Cycle in Perspective

Equity Prices

2005 will be the third year to post a December-to-December gain after three years of declines

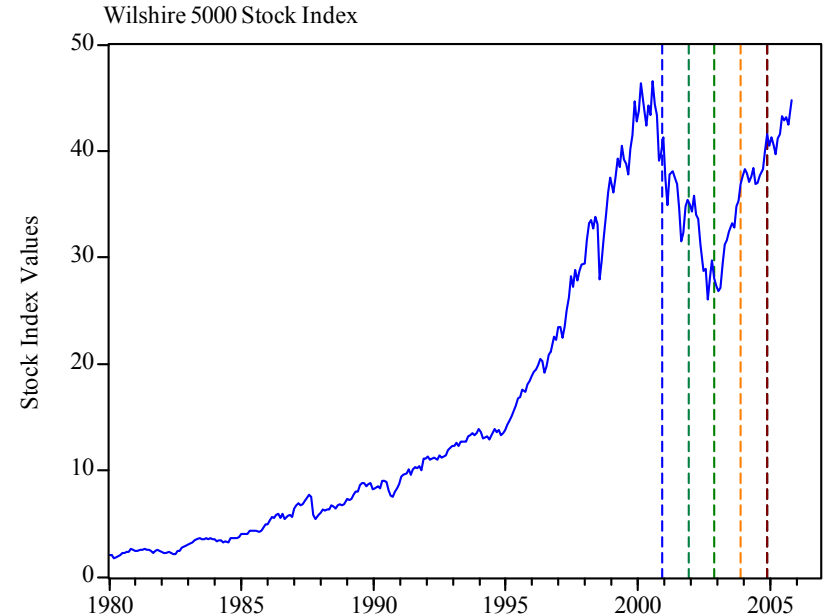
But, the market still has not reached its last peak level

Generally, wealth effect has had minimal effect on spending in the short run

- Wealth loss in 2000-2003 did not adversely affect consumer spending
- Wealth gain in last three years did not buoy spending

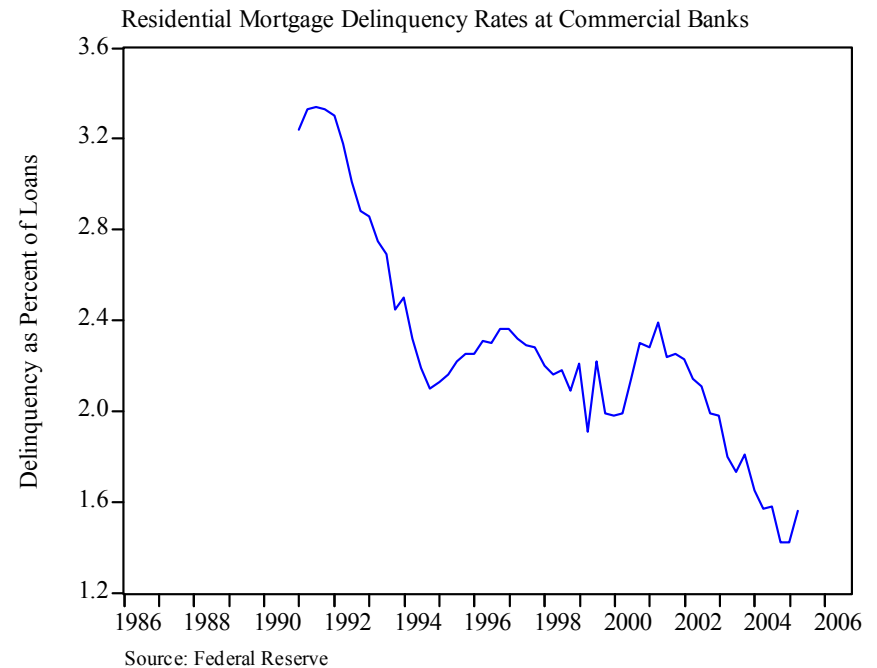
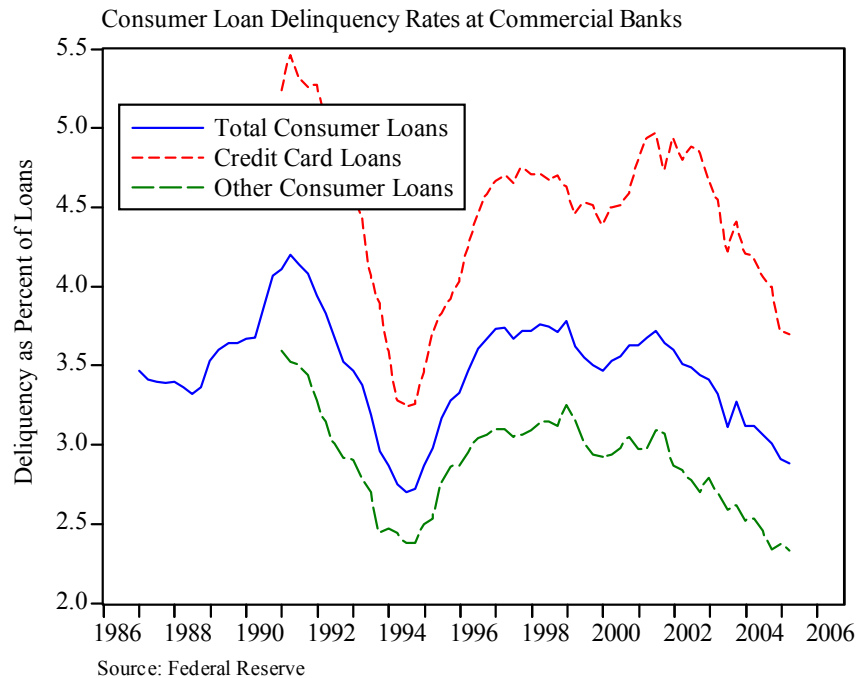
The economy and profits will affect developments in 2006.

Global reallocations by central banks will not affect equity prices unless reallocation has untoward effect on U.S. interest rates



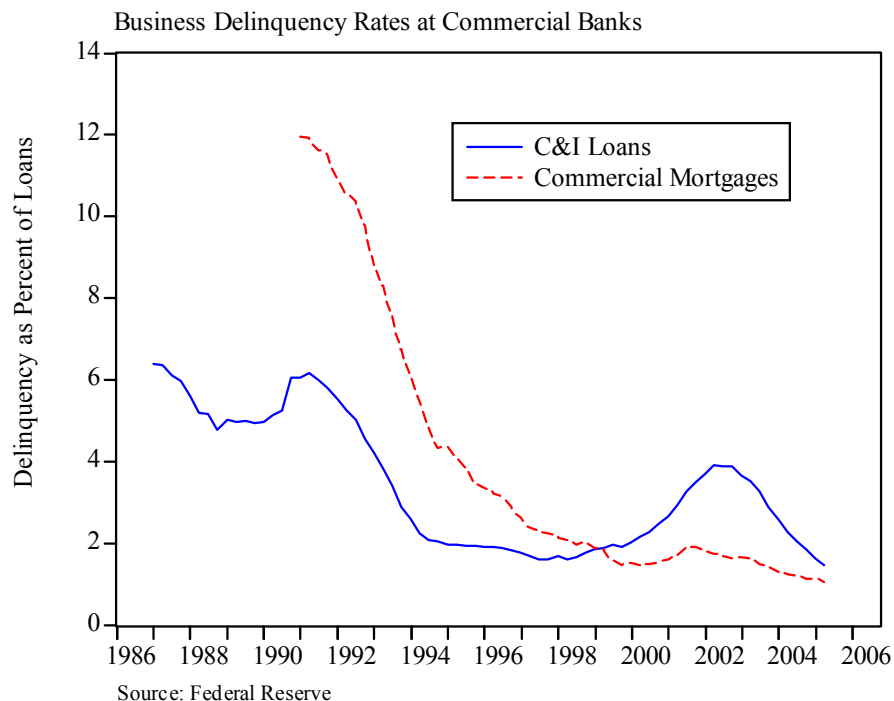
The U.S. Cycle in Perspective

Household Delinquency Rates at Commercial Banks



The U.S. Cycle in Perspective

Business Delinquency Rates at Commercial Banks



C&I loan delinquencies continue their decline

Delinquencies among commercial real estate did not turn upward during the 2000 recession

Looking forward, there is still very good news in the lending area

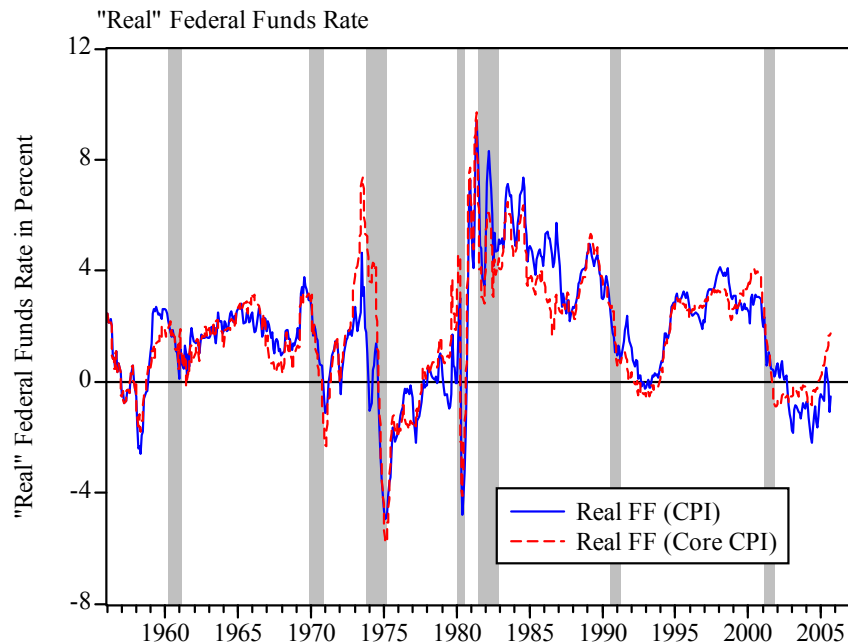
- Bank capital is excellent—a far different condition from the aftermath of the 1990 recession
- The Federal Reserve's effort to remove liquidity has not led to loan quality problems

Bottom line:

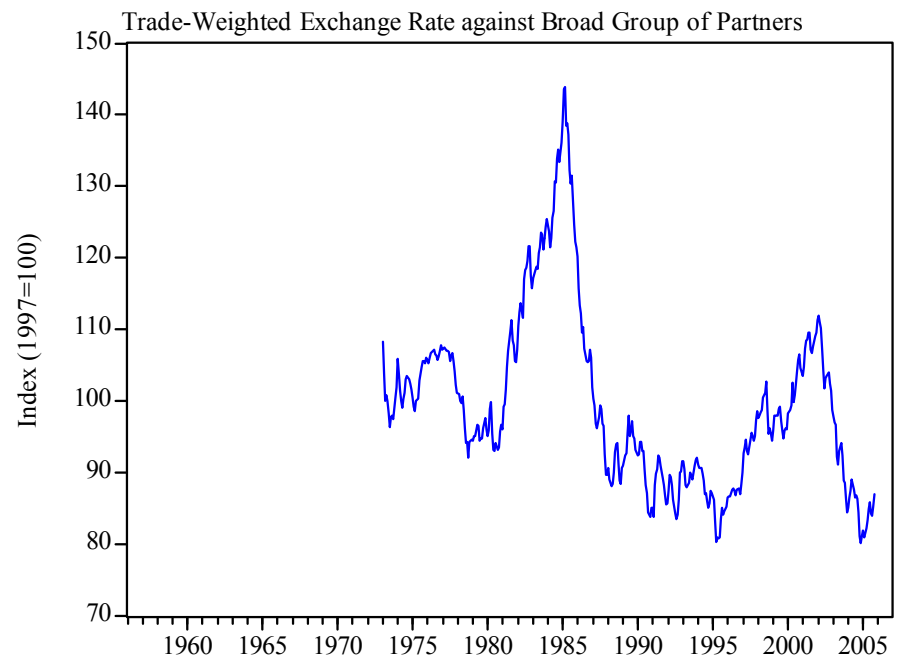
- The economy has ability to continue to finance the current business expansion
- Credit quality of bank borrowers remains very good

The U.S. Cycle in Perspective

Negative Forces: Excessive Monetary Stimulus and Exchange Rate

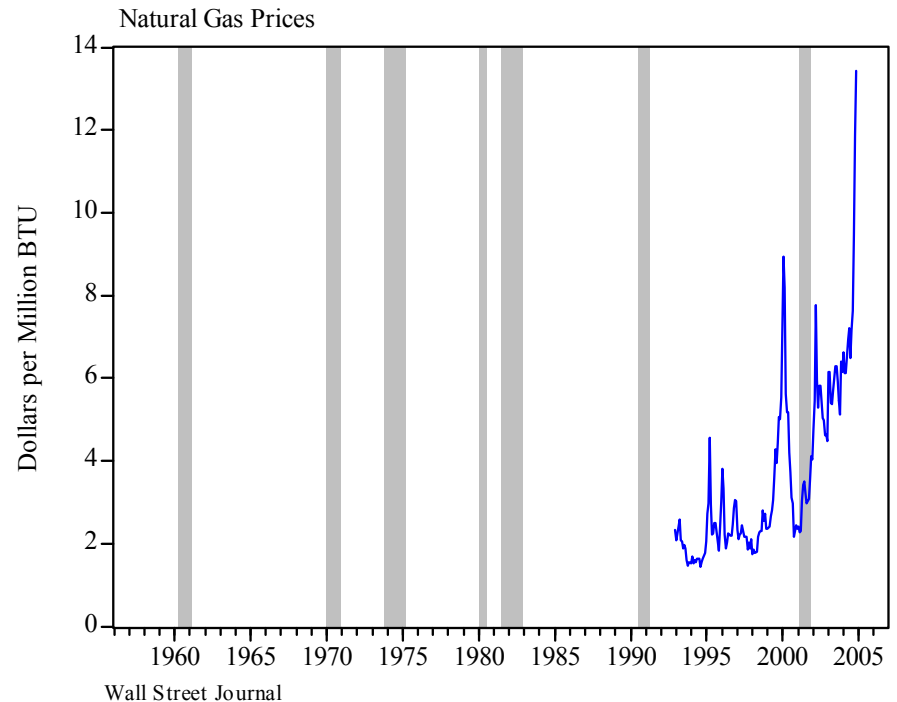
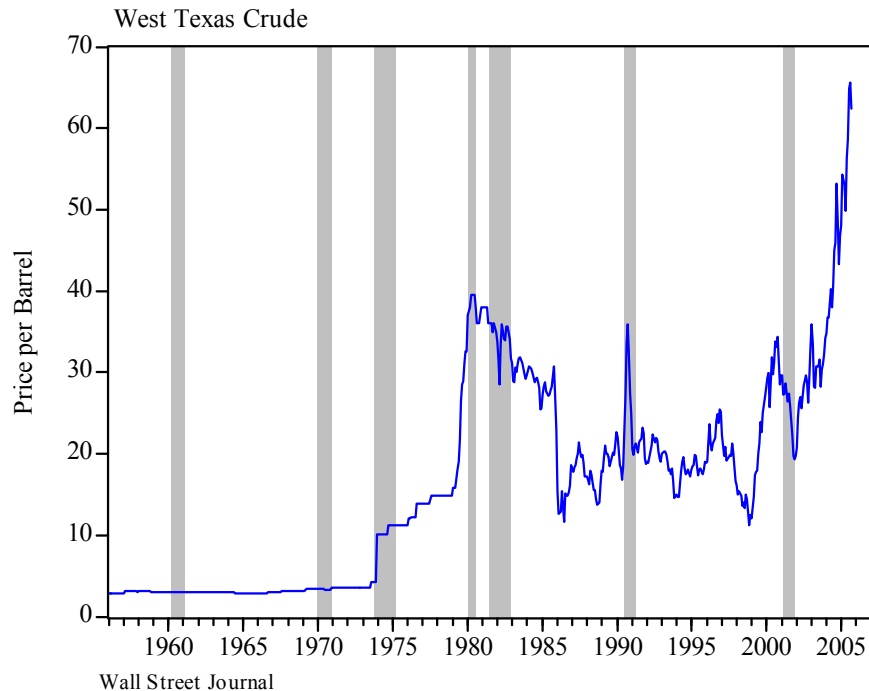


Source: Federal Reserve and Bureau of Labor Statistics



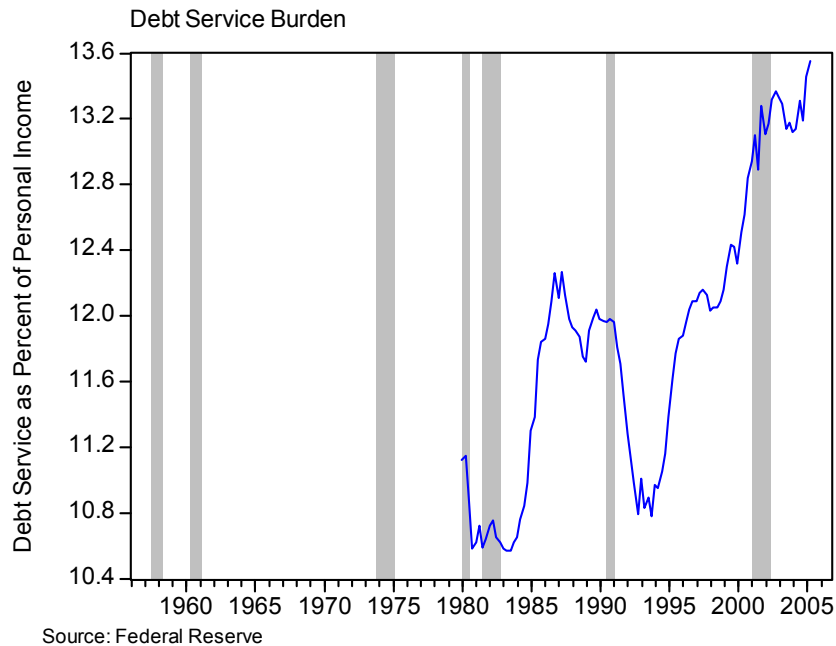
The U.S. Cycle in Perspective

Negative Forces: Oil and Natural Gas Prices



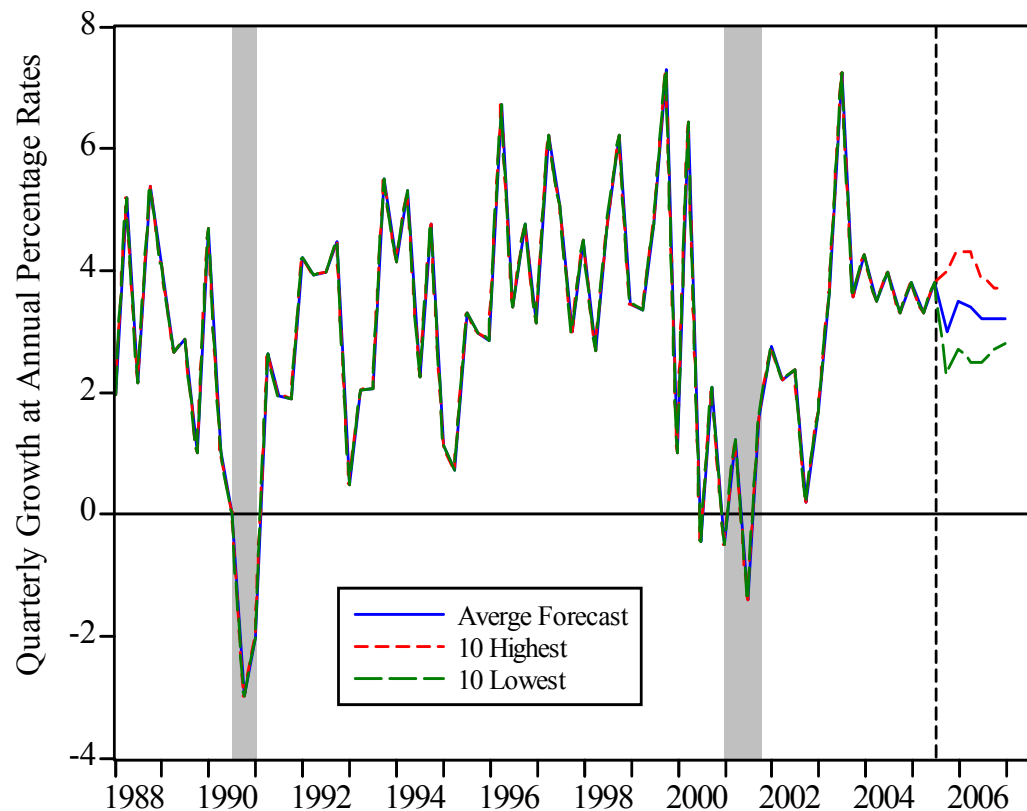
The U.S. Cycle in Perspective

Negative Forces: Household Financial Obligations and the Yield Curve



The U.S. Outlook – Graphic Portrayal

Blue Chip Short-Term Economic Forecasts



Source: Blue Chip Financial Forecasts

Baseline U.S. Outlook

Table 1

		2005				2006				2007				Year-over-Year Growth		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
1	Gross Domestic Product	12198.8	12378.0	12589.6	12755.6	12949.4	13131.2	13321.7	13506.7	13688.9	13875.5	14063.2	14243.3	6.4	6.0	5.6
2	Change *	5.5	5.5	5.5	5.4	6.2	5.7	5.9	5.7	5.5	5.6	5.5	5.2			
3	Gross Dom. Product ('96\$)	10999.3	11089.2	11193.2	11270.4	11389.3	11494.0	11604.5	11710.0	11813.9	11919.4	12026.2	12125.6	3.6	3.7	3.7
4	Change *	3.8	3.3	3.8	2.8	4.3	3.7	3.9	3.7	3.6	3.6	3.6	3.3			
5	Personal Consump. Exp. ('96\$)	7764.9	7829.5	7904.7	7933.4	8014.7	8092.3	8161.4	8231.1	8302.9	8374.9	8448.9	8515.3	3.6	3.4	3.5
6	Change *	3.5	3.4	3.9	1.5	4.2	3.9	3.5	3.5	3.5	3.5	3.6	3.2			
7	Equipment and Software ('96\$)	1014.2	1040.9	1063.3	1086.3	1108.8	1131.2	1157.0	1184.2	1209.8	1234.1	1257.7	1280.5	10.9	9.0	8.8
8	Change *	8.3	11.0	8.9	8.9	8.5	8.3	9.5	9.7	9.0	8.3	7.9	7.4			
9	Nonresid. Construction ('96\$)	251.0	252.7	251.8	252.7	253.7	254.9	255.4	256.7	257.4	258.0	258.3	258.6	1.5	1.2	1.1
10	Change *	-2.0	2.7	-1.4	1.5	1.5	1.9	0.8	2.1	1.0	1.0	0.5	0.4			
11	Resid. Construction ('96\$)	584.1	599.3	606.3	609.8	609.1	612.0	614.3	615.5	615.6	617.2	619.5	620.8	6.8	2.1	0.9
12	Change *	9.5	10.8	4.8	2.3	-0.4	1.9	1.5	0.8	0.1	1.0	1.5	0.8			
13	Federal Defense ('96\$)	487.3	491.7	503.9	503.2	502.6	504.4	506.2	508.7	509.0	510.5	513.1	515.6	3.2	1.8	1.3
14	Change *	3.0	3.7	10.3	-0.6	-0.5	1.5	1.4	2.0	0.2	1.2	2.1	1.9			
15	Fed. Nondefense ('96\$)	244.3	244.2	245.7	247.5	249.0	250.3	252.0	253.7	255.4	257.0	258.8	260.5	1.3	2.4	2.7
16	Change *	1.2	-0.2	2.5	2.9	2.5	2.1	2.7	2.8	2.7	2.6	2.7	2.7			
17	State + Local ('96\$)	1239.8	1247.8	1249.8	1257.9	1265.7	1273.5	1281.5	1289.5	1297.6	1305.8	1314.0	1322.3			
18	Change *	1.6	2.6	0.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	1.7	2.3	2.5
19	Net Exports ('96\$)	-645.4	-614.2	-611.8	-613.6	-627.9	-644.2	-649.6	-658.3	-664.8	-671.4	-679.1	-682.7			
20	Chg. in Bus. Invent. ('96\$)	58.2	-1.7	-16.6	-6.9	13.5	19.6	26.3	28.8	31.0	33.2	35.0	34.7			
21	Nonfarm Inventories	61.8	3.4	-9.8	-4.5	14.5	20.0	26.4	28.9	31.0	33.2	35.0	34.7			
22	Farm Inventories	-2.3	-4.2	-5.9	-2.4	-1.0	-0.4	-0.2	-0.1	0.0	0.0	0.0	0.0			
23	GNP Deflator ('96=100) *	3.0	2.6	3.1	2.5	1.9	1.9	2.0	1.9	1.8	1.9	1.8	1.8	2.7	2.2	1.9
24	CPI (1982-84=100) *	2.4	4.2	5.1	4.4	2.1	2.6	2.5	2.5	2.4	2.4	2.3	2.3	3.4	3.2	2.4
25	PPI (1982=100) *	2.8	3.3	7.3	6.8	0.2	1.2	1.6	1.5	1.4	1.5	1.4	1.2	4.8	2.9	1.4

Cyclical Characteristics

Table 2

		2005				2006				2007				Year-over-Year Growth		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
1	Domestic Final Sales ('96\$)	11586.5	11705.1	11821.6	11890.8	12003.6	12118.6	12227.8	12339.4	12447.7	12557.6	12670.4	12773.5	3.6	3.8	3.5
2	Change *	3.7	4.2	4.0	2.4	3.8	3.9	3.7	3.7	3.6	3.6	3.6	3.3			
3	Cyclical Domestic Demand ('96\$)	2971.6	3036.8	3094.9	3066.8	3111.8	3155.6	3193.4	3232.7	3270.2	3307.7	3346.6	3376.4	6.8	4.3	4.8
4	Change *	5.4	9.1	7.9	-3.6	6.0	5.7	4.9	5.0	4.7	4.7	4.8	3.6			
5	Cyclical Consumer Demand ('96\$)	1122.3	1143.9	1173.5	1118.0	1140.2	1157.5	1166.7	1176.3	1187.5	1198.4	1211.1	1216.5	4.5	1.8	3.7
6	Change *	2.6	7.9	10.8	-17.6	8.2	6.2	3.2	3.3	3.8	3.7	4.3	1.8			
7	Light Vehicles and Parts ('96\$)	449.6	458.5	473.7	410.7	425.6	434.8	436.5	438.4	441.7	444.8	449.5	447.5	1.4	-3.2	2.8
8	Change *	-2.8	8.2	13.9	-43.5	15.3	8.9	1.6	1.8	3.0	2.8	4.3	-1.7			
9	Other Durables ('96\$)	672.7	685.4	699.8	707.4	714.6	722.8	730.2	737.9	745.7	753.6	761.6	769.0	6.7	5.1	4.3
10	Change *	6.4	7.8	8.7	4.4	4.2	4.6	4.2	4.3	4.3	4.3	4.3	3.9			
11	Fixed Investment ('96\$)	1842.2	1884.7	1911.0	1948.8	1971.6	1998.1	2026.7	2056.3	2082.8	2109.3	2135.5	2159.9	8.1	6.1	5.4
12	Change *	7.3	7.4	7.4	8.2	4.8	5.5	5.9	6.0	5.2	5.2	5.1	4.6			
13	Resid. Construction ('96\$)	584.1	599.3	606.3	609.8	609.1	612.0	614.3	615.5	615.6	617.2	619.5	620.8	6.8	2.1	0.9
14	Change *	9.5	10.8	4.8	2.3	-0.4	1.9	1.5	0.8	0.1	1.0	1.5	0.8			
15	Nonresid. Construction ('96\$)	251.0	252.7	251.8	252.7	253.7	254.9	255.4	256.7	257.4	258.0	258.3	258.6	1.5	1.2	1.1
16	Change *	-2.0	2.7	-1.4	1.5	1.5	1.9	0.8	2.1	1.0	1.0	0.5	0.4			
17	Equipment and Software ('96\$)	1014.2	1040.9	1063.3	1086.3	1108.8	1131.2	1157.0	1184.2	1209.8	1234.1	1257.7	1280.5	10.9	9.0	8.8
18	Change *	8.3	11.0	8.9	8.9	8.5	8.3	9.5	9.7	9.0	8.3	7.9	7.4			
19	Noncyclical Demand ('96\$)@	8027.7	8052.4	8098.3	8203.6	8277.4	8338.4	8411.1	8477.3	8543.6	8611.7	8679.6	8749.1	2.4	3.5	3.2
20	Change *	3.2	1.2	2.3	5.3	3.7	3.0	3.5	3.2	3.2	3.2	3.2	3.2			
21	Chg. in Business Inventories	58.2	-1.7	-16.6	-6.9	13.5	19.6	26.3	28.8	31.0	33.2	35.0	34.7			
22	Gross Domestic Purchases ('96\$)&	11644.3	11704.8	11809.4	11883.9	12017.1	12138.2	12254.1	12368.3	12478.7	12590.8	12705.3	12808.3	3.6	3.7	3.7
23	Change *	4.1	2.1	3.6	2.5	4.6	4.1	3.9	3.8	3.6	3.6	3.7	3.3			
24	Net Exports ('96\$)	-645.4	-614.2	-611.8	-613.6	-627.9	-644.2	-649.6	-658.3	-664.8	-671.4	-679.1	-682.7			
25	GDP ('96\$)**	10999.3	11089.2	11193.2	11270.4	11389.3	11494.0	11604.5	11710.0	11813.9	11919.4	12026.2	12125.6	3.6	3.7	3.7
	Change *	3.8	3.3	3.8	2.8	4.3	3.7	3.9	3.7	3.6	3.6	3.6	3.3			

@ Noncyclical Demand = Consumer spending on nondurable goods and services and all forms of government spending (excluding CCC inventories)

& Gross Domestic Purchases = Domestic final demand plus Change *

* Quarter-to-quarter percent Change *

A = Actual; E = Forecast

Except for price indexes, all data in billions of dollars

Historical sources: BEA and BLS

November 27, 2005

Household Sector

Table 3

		2005				2006				2007				Year-over-Year Growth		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
1	Personal Income (\$ Bil.)	10073.4	10221.2	10293.0	10392.3	10544.4	10688.8	10846.4	10995.8	11134.9	11285.4	11433.4	11584.7	5.5	5.1	5.5
2	Change *	2.0	6.0	2.8	3.9	6.0	5.6	6.0	5.6	5.2	5.5	5.4	5.4			
3	Civilian Employment (Mil.)	140.3	141.4	142.3	142.8	143.4	144.0	144.6	145.2	145.8	146.4	147.0	147.5	1.8	1.8	1.6
4	Change *	0.6	3.2	2.6	1.5	1.6	1.6	1.7	1.7	1.6	1.6	1.6	1.6			
5	Unemployment Rate	5.3	5.1	5.0	5.0	5.0	4.9	4.9	4.9	4.8	4.8	4.7	4.6			
6	Personal Consump. Exp. ('96\$)	7764.9	7829.5	7904.7	7933.4	8014.7	8092.3	8161.4	8231.1	8302.9	8374.9	8448.9	8515.3	3.6	3.4	3.5
7	Change *	3.5	3.4	3.9	1.5	4.2	3.9	3.5	3.5	3.5	3.5	3.6	3.2			
8	Autos & Parts	449.6	458.5	473.7	410.7	425.6	434.8	436.5	438.4	441.7	444.8	449.5	447.5	1.4	-3.2	2.8
9	Change *	-2.8	8.2	13.9	-43.5	15.3	8.9	1.6	1.8	3.0	2.8	4.3	-1.7			
10	Other Durable Goods	672.7	685.4	699.8	707.4	714.6	722.8	730.2	737.9	745.7	753.6	761.6	769.0	6.7	5.1	4.3
11	Change *	6.4	7.8	8.7	4.4	4.2	4.6	4.2	4.3	4.3	4.3	4.3	3.9			
12	Nondurable Goods	2265.6	2285.9	2300.6	2328.7	2350.6	2375.1	2398.6	2422.3	2446.3	2470.5	2494.6	2518.3	4.3	4.0	4.0
13	Change *	5.3	3.6	2.6	5.0	3.8	4.2	4.0	4.0	4.0	4.0	4.0	3.9			
14	Services	4392.0	4417.6	4452.5	4486.7	4523.8	4559.6	4596.1	4632.4	4669.1	4706.0	4743.2	4780.4	2.9	3.2	3.2
15	Change *	2.8	2.4	3.2	3.1	3.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2			
16	Lt. Vehicles	16.5	17.2	17.9	15.4	15.9	16.2	16.1	16.1	16.1	16.0	16.1	15.9	-0.7	-4.1	-0.4
17	Change *	-14.0	18.3	17.5	-45.8	14.4	7.1	-1.7	-0.2	-0.6	-1.1	0.8	-5.0			
18	New Auto Sales (Mil.)	7.5	7.6	8.0	8.5	8.7	8.7	8.5	8.4	8.4	8.3	8.4	8.2	5.2	8.7	-3.0
19	Change *	-8.6	7.7	17.0	27.8	10.3	3.2	-8.8	-7.5	-0.6	-1.1	0.8	-5.0			
20	New Light Truck Sales (Mil.)	9.0	9.6	10.0	6.9	7.2	7.4	7.6	7.7	7.7	7.7	7.7	7.6	-5.3	-15.5	2.5
21	Change *	-18.3	27.6	18.0	-76.8	19.6	11.8	7.2	8.6	-0.6	-1.1	0.8	-5.0			
22	Private Housing Starts (Mil.)	2.083	2.044	2.092	2.052	2.044	2.038	2.027	2.011	1.990	1.984	1.973	1.958	6.1	-1.8	-2.7
23	Change *	24.2	-7.2	9.7	-7.5	-1.6	-1.1	-2.1	-3.1	-4.1	-1.3	-2.1	-3.1			
24	Single-Family	1.709	1.693	1.740	1.704	1.700	1.696	1.687	1.675	1.658	1.654	1.646	1.633			
25	Multi-Family	0.374	0.351	0.352	0.348	0.344	0.342	0.340	0.337	0.332	0.330	0.328	0.324			
26	Existing Home Sales (Th.)	6836.7	7223.3	7236.7	7307.3	7462.6	7582.4	7702.9	7841.2	7980.7	8125.7	8274.4	8426.0	6.4	6.9	7.3
27	Change *	0.0	0.0	0.0	4.0	8.8	6.6	6.5	7.4	7.3	7.5	7.5	7.5			

Corporate Sector

Table 4

		2005				2006				2007				Year-over-Year Growth		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
1	Fixed Business Invest. ('96\$)	1252.2	1279.0	1298.4	1339.1	1362.5	1386.0	1412.4	1440.9	1467.2	1492.1	1516.0	1539.1	8.9	8.4	7.4
2	Change *	8.4	8.4	8.4	13.1	7.2	7.1	7.8	8.3	7.5	7.0	6.6	6.2			
3	Structures	251.0	252.7	251.8	252.7	253.7	254.9	255.4	256.7	257.4	258.0	258.3	258.6	1.5	1.2	1.1
4	Change *	-2.0	2.7	-1.4	1.5	1.5	1.9	0.8	2.1	1.0	1.0	0.5	0.4			
5	Producer Equip. & Software	1014.2	1040.9	1063.3	1086.3	1108.8	1131.2	1157.0	1184.2	1209.8	1234.1	1257.7	1280.5	10.9	9.0	8.8
6	Change *	8.3	11.0	8.9	8.9	8.5	8.3	9.5	9.7	9.0	8.3	7.9	7.4			
7	Chg. in Bus. Invent. ('96\$)	58.2	-1.7	-16.6	-6.9	13.5	19.6	26.3	28.8	31.0	33.2	35.0	34.7			
8	Chg. in Nonfarm Inventories	61.8	3.4	-9.8	-4.5	14.5	20.0	26.4	28.9	31.0	33.2	35.0	34.7			
9	Corporate Profits (B.T.)	1378.3	1412.2	1460.3	1515.8	1526.9	1558.9	1595.9	1624.0	1664.1	1699.4	1734.2	1766.1			
10	Corporate Profits (A.T.)	1015.7	1039.7	1075.2	1116.0	1124.2	1147.7	1175.0	1195.7	1225.2	1251.2	1276.8	1300.3	34.7	9.3	8.9
11	Change *	123.1	9.8	14.4	16.1	3.0	8.6	9.9	7.2	10.2	8.8	8.4	7.6			
12	Internal Funds (A.T.)	915.7	927.3	945.1	969.8	970.8	983.4	996.8	1008.3	1025.3	1040.1	1054.9	1070.5	-2.7	5.4	5.8
13	Change *	9.4	5.2	7.9	10.9	0.4	5.3	5.5	4.7	6.9	5.9	5.8	6.1			
14	Dividends	494.9	506.3	520.1	532.3	544.8	557.3	570.1	582.7	595.4	608.1	621.0	633.9	4.1	9.8	9.0
15	Change *	-50.3	9.5	11.4	9.7	9.7	9.5	9.5	9.2	8.9	8.8	8.8	8.5			
16	Output per Hour *	3.0	0.6	4.8	1.5	3.0	2.3	2.4	2.2	2.2	2.2	2.2	2.0	2.5	2.5	2.2
17	Hourly Compensation *	4.3	4.3	4.3	4.2	3.8	4.5	3.8	4.0	3.6	3.9	3.7	3.5	5.6	4.0	3.8
18	Unit Labor Costs *	1.7	2.3	-0.7	2.7	0.9	2.2	1.4	1.8	1.4	1.6	1.5	1.5	3.0	1.5	1.6

International Sector

Table 5

		2005				2006				2007				Year-over-Year Growth		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
1	Net Exports ('96\$)	-645.4	-614.2	-611.8	-613.6	-627.9	-644.2	-649.6	-658.3	-664.8	-671.4	-679.1	-682.7			
2	Exports ('96\$)	1165.3	1195.4	1197.6	1208.7	1225.8	1243.8	1271.0	1292.8	1313.9	1336.3	1357.6	1382.4	6.6	5.6	7.1
3	Change *	7.5	10.7	0.7	3.8	5.8	6.0	9.0	7.0	6.7	7.0	6.5	7.5			
4	Imports ('96\$)	1810.7	1809.6	1809.4	1822.3	1853.6	1888.0	1920.5	1951.1	1978.7	2007.6	2036.7	2065.1	5.5	5.0	6.2
5	Change *	7.4	-0.2	0.0	2.9	7.1	7.6	7.1	6.5	5.8	6.0	5.9	5.7			
6	Trade-Weighted Index	81.3	83.5	84.6	85.3	85.7	86.0	86.2	86.7	87.2	87.6	88.1	88.9	-2.0	2.9	2.1

Except where noted, all data in billions of dollars

Historical sources: BEA, BLS, and Federal Reserve

* Quarter-to-quarter percent changes expressed at compound annual rates

A = Actual; E = Forecast

November 27, 2005



Outlook for Interest Rates

Market Based Forecasts: Futures Market over the Next Year

Futures market sees increases in the federal funds rate continuing in 2006

- At the time the interest rate outlook was constructed, futures market saw federal funds rate at around 4.75 percent by mid-2006.
- Pattern of the rate increases gyrates as markets adjust to incoming data

Analysts now shifting to view that the FOMC will be less aggressive in 2006

- As of Friday (11/25) rate is expected to reach 4.5 percent in the February-April time frame but it is uncertain as to whether it will get to 4.75 percent
- Contracts for remainder of the year point to 4 5/8 rate

Federal Funds Future Contract			
Contract Expiration	Settlement Index Price	Implied Rate	
Nov-05	96.000	4.000	
Dec-05	95.840	4.160	
Jan-06	95.735	4.265	
Feb-06	95.550	4.450	
Mar-06	95.525	4.475	
Apr-06	95.410	4.590	
May-06	95.385	4.615	
Jun-06	95.365	4.635	
Jul-06	95.365	4.635	
Aug-06	95.365	4.635	
Sep-06	95.365	4.635	
Oct-06	95.365	4.635	
Nov-06	95.370	4.630	

Source: Chicago Board of Options Trading

Table generated November 25, 2005; 17:00 CST



Outlook for Interest Rates

Survey Results and the MTSU Outlook

Blue Chip Financial forecast: 2006

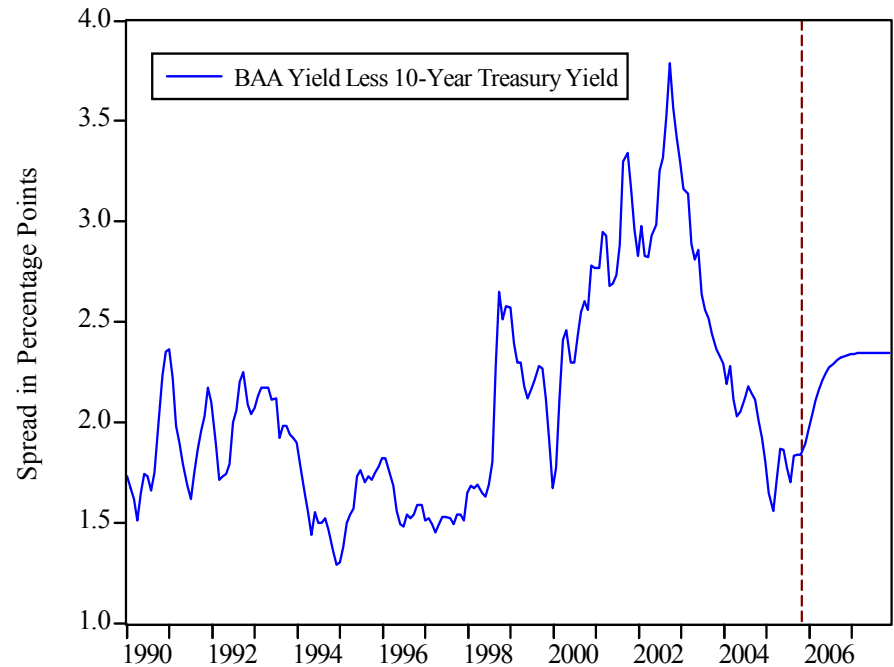
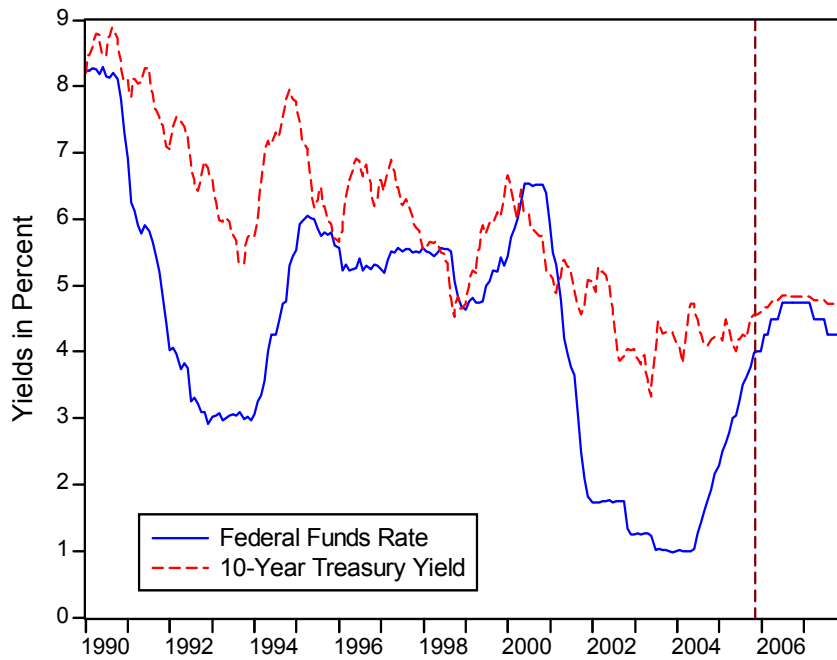
- Short-term rates
 - Federal funds rate reaches 4.50 percent by the end of the second quarter and tops out in the vicinity of $4 \frac{5}{8}$ percent by mid year.
- Long-term rates
 - 10-Year bond yield rises gradually through the first half of 2006, reaching 5.10 percent by the third quarter

Baseline MTSU forecast: 2005-2006

- Federal funds rate increases continue into 2006
- After reaching their peak in mid-2006, short-term rates will remain stable for about a year and then fall to around 4 percent for the remainder of the long-term outlook
- The speed of the removal of liquidity following September 11, 2001, kept long-term interest rates from rising dramatically during the current interest rate cycle
- Credit risk spreads are now narrow compared with early years of this decade
- But the spreads will likely rise as economic activity moderates

Interest Rate Outlook – Graphic Portrayal

MTSU Baseline Interest Rate Forecast



Money Market Interest Rates

Table 6

		2005				2006				2007				Annual Averages		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2004	2005	2006
1	Federal Funds	2.47	2.94	3.46	3.92	4.17	4.50	4.75	4.75	4.75	4.50	4.33	4.25	3.20	4.54	4.46
Commercial Paper																
2	1-Month	2.50	2.97	3.46	3.97	4.20	4.59	4.82	4.84	4.84	4.64	4.49	4.41	3.22	4.61	4.60
3	3-Month	2.57	3.05	3.52	4.03	4.29	4.64	4.89	4.92	4.93	4.70	4.56	4.49	3.29	4.69	4.67
4	6-Month	2.67	3.11	3.61	4.12	4.36	4.71	4.96	4.99	4.99	4.76	4.61	4.54	3.38	4.75	4.73
Finance Paper																
5	1-Month	2.53	3.01	3.50	3.99	4.19	4.56	4.80	4.81	4.80	4.60	4.45	4.38	3.26	4.59	4.56
6	3-Month	2.63	3.09	3.58	4.08	4.31	4.66	4.91	4.94	4.95	4.72	4.58	4.51	3.34	4.71	4.69
7	6-Month	2.73	3.16	3.66	4.17	4.38	4.72	4.96	4.98	4.98	4.74	4.58	4.51	3.43	4.76	4.70
Treasury Bills																
8	1-Month	2.58	2.93	3.43	3.94	4.19	4.51	4.75	4.76	4.76	4.51	4.34	4.26	3.22	4.55	4.47
9	3-Month	2.87	3.18	3.70	4.26	4.46	4.72	4.90	4.89	4.88	4.65	4.51	4.44	3.50	4.74	4.62
Negotiable CDs																
10	1-Month	2.59	3.06	3.56	4.08	4.30	4.71	4.94	4.95	4.94	4.73	4.56	4.48	3.32	4.72	4.68
11	3-Month	2.78	3.23	3.74	4.25	4.49	4.84	5.10	5.12	5.11	4.87	4.70	4.61	3.50	4.89	4.82
12	6-Month	3.03	3.45	3.93	4.46	4.69	4.96	5.13	5.12	5.12	4.89	4.75	4.68	3.72	4.98	4.86
Eurodollar Deposit																
13	1-Month	2.57	3.05	3.54	4.09	4.30	4.68	4.91	4.94	4.92	4.70	4.53	4.46	3.31	4.71	4.65
14	3-Month	2.77	3.21	3.71	4.27	4.49	4.84	5.09	5.12	5.12	4.87	4.70	4.62	3.49	4.88	4.82
15	6-Month	3.00	3.43	3.91	4.47	4.71	4.97	5.13	5.13	5.14	4.90	4.76	4.70	3.70	4.99	4.87

Capital Market Instruments

Table 7

		2005				2006				2007				Annual Averages		
		I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
U.S. Treasury Notes and Bonds																
1	1-Yr Note	3.06	3.34	3.79	4.32	4.58	4.84	5.02	4.94	4.94	4.64	4.50	4.50	3.63	4.85	4.64
2	2-Yr Note	3.44	3.64	3.95	4.39	4.58	4.82	4.99	4.97	4.96	4.76	4.62	4.56	3.86	4.84	4.73
3	5-Yr Note	3.88	3.87	4.04	4.44	4.60	4.77	4.89	4.88	4.88	4.76	4.68	4.64	4.06	4.79	4.74
4	10-Yr Note	4.30	4.16	4.21	4.53	4.65	4.76	4.84	4.84	4.83	4.77	4.74	4.72	4.30	4.77	4.77
5	30-Yr Note	4.76	4.55	4.51	4.81	4.77	4.77	4.82	4.78	4.79	4.80	4.77	4.77	4.66	4.79	4.78
Other Bonds																
6	AAA Bonds	5.32	5.15	5.09	5.42	5.68	5.93	6.10	6.18	6.23	6.21	6.21	6.21	5.25	5.97	6.22
7	BAA Bonds	5.97	5.97	5.98	6.39	6.68	6.97	7.13	7.16	7.18	7.12	7.08	7.07	6.08	6.99	7.11
8	State and Local	4.44	4.33	4.31	4.54	4.67	4.82	4.93	4.96	4.98	4.95	4.94	4.93	4.41	4.84	4.95
Mortgage Rates - Primary Mkt																
9	30-Yr (FHLMC - PMMS)	5.51	5.51	5.61	6.15	6.23	6.35	6.46	6.48	6.49	6.44	6.41	6.40	5.70	6.38	6.44
10	15-Yr (FHLMC - PMMS)	4.96	5.01	5.14	5.64	5.83	6.03	6.18	6.19	6.20	6.10	6.03	6.00	5.19	6.06	6.08
11	ARM (FHLMC - PMMS)	4.17	4.24	4.49	5.10	5.60	6.08	6.44	6.50	6.60	6.39	6.31	6.35	4.50	6.16	6.41
Mortgage Rates - Secondary Mkt																
12	30-Yr (FLHMC Req Net Yield)	5.76	5.72	5.76	6.28	6.45	6.57	6.65	6.65	6.65	6.59	6.55	6.53	5.88	6.58	6.58
13	15-Yr (FHLMC Req Net Yield)	5.26	5.29	5.35	5.80	5.98	6.13	6.23	6.20	6.18	6.05	5.95	5.90	5.42	6.14	6.02

Sources: Federal Reserve, Federal Home Loan Bank, Federal Home Loan Mortgage Corp.
A = Actual; E = Forecast

November 23, 2005

The Tennessee Cycle in Perspective

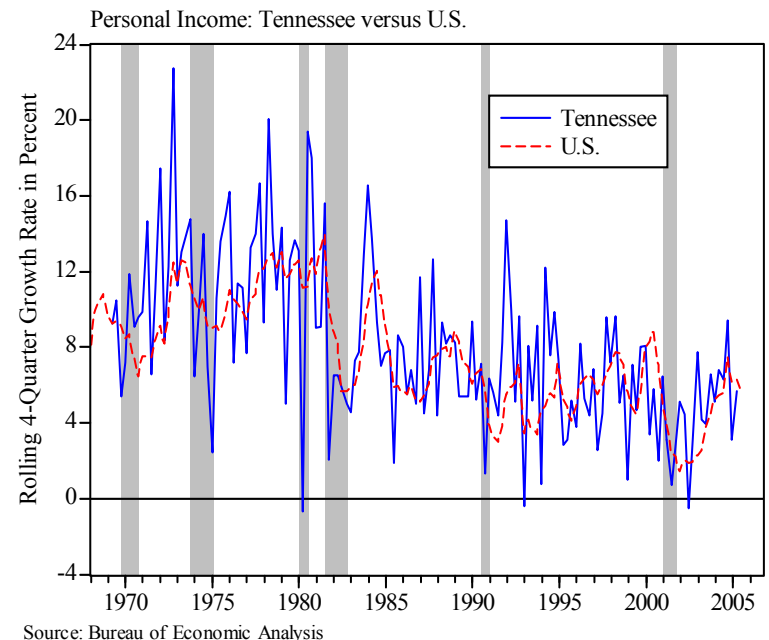
Personal Income – Tennessee versus U.S.

Quarterly growth in state and nation follows roughly the same cyclical pattern

- Historically, each 1% growth in the U.S. is met with 1% growth in Tennessee with a lapse of about eight quarters
- Admittedly, there are sizeable short-run deviations between the two

So far in this expansion, the rolling four-quarter growth of personal income for Tennessee is tracking the U.S. pattern

But both Tennessee and U.S. may be in the early stage of decelerating income growth



The Tennessee Cycle in Perspective

Labor Markets – Tennessee versus U.S.

Tennessee's growth pattern moves roughly in tandem with U.S. over time, but differences are evident

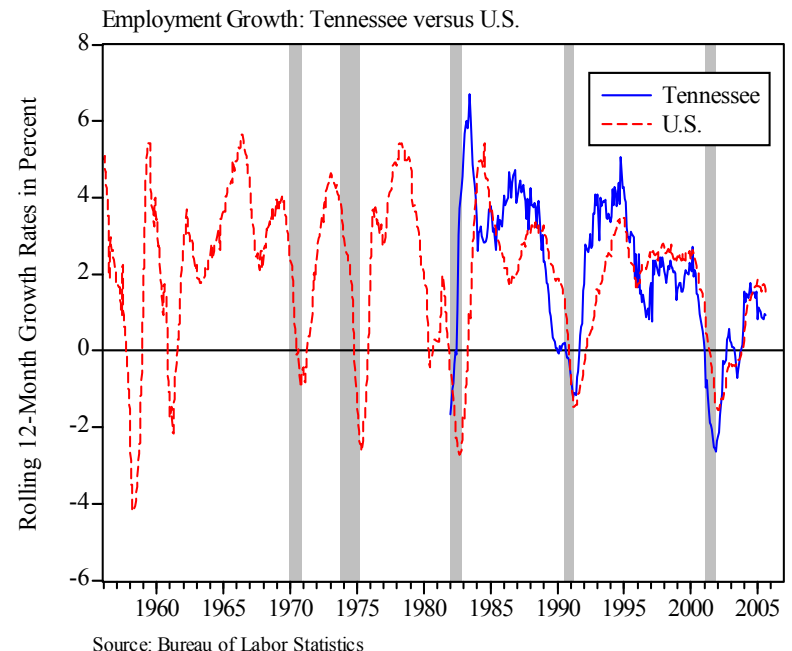
Pattern has tighter co-movement as decline gathers momentum

Historically, Tennessee typically had a stronger employment growth than the country as a whole in the upswing

But Tennessee and U.S. are moving in close tandem in this expansion in upswing

U.S. appears to be in the early stage of decelerating growth

Tennessee growth still appears strong



The Tennessee Cycle in Perspective

Housing Activity – Tennessee versus U.S.

Housing in Tennessee generally moves with the U.S. housing cycle

For 2004 and so far in 2005, housing in Tennessee is in line with U.S. housing activity

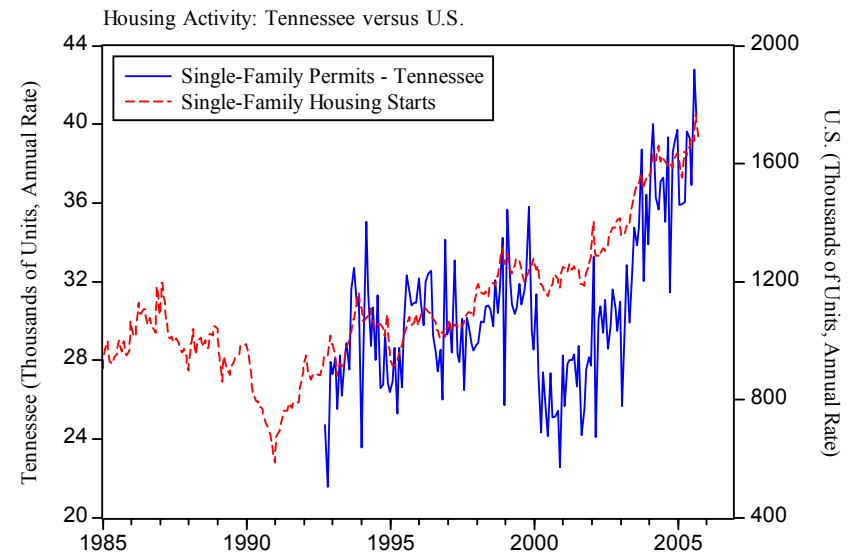
Rebound in late 2003, 2004, and so far in 2005 is attributable to lower mortgage rates for both Tennessee and U.S.

Because of this, many see the housing boom as a potential bubble

- If so and if the bubble bursts, both the volume of permits and valuation could be at risk

Housing in Tennessee is more volatile than in the U.S.

- Expansion in Tennessee and the U.S. seem to move together
- Downturn is more severe in Tennessee than the country as a whole
- Implication: if there is a slowdown in housing, activity could fall dramatically in Tennessee



Source: Bureau of the Census

The Tennessee Cycle in Perspective

Consumer Spending

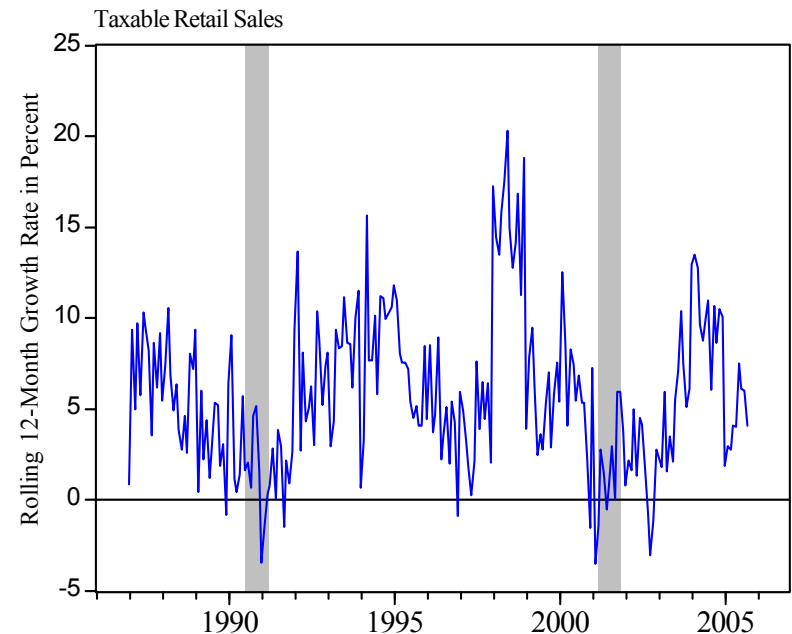
Pattern of slower growth the 1990 recession
was repeated after the 2001 recession

In both cases, growth eventually accelerated

However, recent growth is at slower pace
than a few years ago

Since inflation is lower, this represents
stronger growth in real terms compared
with the last expansion

Problem: even so, pace of nominal sales
growth may not be supportive of strong
growth in tax revenue



Baseline Tennessee Outlook

Table 8

	2005				2006				2007				Year-over-Year Growth		
	I(A) 2005	II(A) 2005	III(A) 2005	IV(E) 2005	I(E) 2006	II(E) 2006	III(E) 2006	IV(E) 2006	I(E) 2007	II(E) 2007	III(E) 2007	IV(E) 2007	2005	2006	2007
National Trends															
1 Civilian Employment (Mil.)	140.3	141.4	142.3	142.8	143.4	144.0	144.6	145.2	145.8	146.4	147.0	147.5	1.8	1.8	1.6
2 Change *	0.6	3.2	2.6	1.5	1.6	1.6	1.7	1.7	1.6	1.6	1.6	1.6			
3 Personal Income	10073.4	10221.2	10293.0	10392.3	10544.4	10688.8	10846.4	10995.8	11134.9	11285.4	11433.4	11584.7	5.5	5.1	5.5
4 Change *	2.0	6.0	2.8	3.9	6.0	5.6	6.0	5.6	5.2	5.5	5.4	5.4			
5 Income Per Employee (T)	71.801	72.284	72.323	72.758	73.530	74.235	75.015	75.728	76.374	77.096	77.797	78.524	3.6	3.2	3.8
6 Change *	1.4	2.7	0.2	2.4	4.3	3.9	4.3	3.9	3.5	3.8	3.7	3.8			
7 Housing Starts (Mil. of Units)	2.083	2.044	2.092	2.052	2.044	2.038	2.027	2.011	1.990	1.984	1.973	1.958	6.1	-1.8	-2.7
8 Change *	24.2	-7.2	9.7	-7.5	-1.6	-1.1	-2.1	-3.1	-4.1	-1.3	-2.1	-3.1			
Tennessee															
9 Nonagricultural Employment (T)	2719.5	2723.8	2725.6	2727.4	2732.0	2739.1	2747.6	2757.1	2766.5	2776.0	2786.0	2795.6	0.9	0.7	1.4
10 Change *	0.7	0.6	0.3	0.3	0.7	1.0	1.2	1.4	1.4	1.4	1.4	1.4			
11 Personal Income	182.3	184.9	186.3	188.2	190.7	193.3	196.0	198.6	201.2	203.9	206.6	209.4	5.4	5.0	5.5
12 Change *	3.1	5.7	3.1	4.1	5.5	5.4	5.8	5.5	5.2	5.5	5.4	5.4			
13 Dividends & Interest	20.3	20.6	20.9	21.1	21.3	21.5	21.6	21.8	22.0	22.1	22.3	22.5	0.9	3.9	3.2
14 Change *	-17.5	4.4	7.5	3.4	3.3	3.2	3.3	3.2	3.1	3.2	3.1	3.0			
15 Income Per Employee (T)	67.052	67.876	68.349	68.994	69.812	70.555	71.329	72.050	72.730	73.454	74.162	74.892	4.5	4.2	4.0
16 Change *	2.4	5.0	2.8	3.8	4.8	4.3	4.5	4.1	3.8	4.0	3.9	4.0			
17 Retail Sales	77.8	79.1	81.0	82.2	83.7	85.2	86.8	88.4	89.9	91.5	93.2	94.8	4.7	7.5	7.4
18 Change *	-0.4	7.1	10.1	6.1	7.4	7.3	7.6	7.5	7.2	7.4	7.3	7.2			
19 Single-Family Building Permits (T)	37.190	38.325	40.049	38.577	38.231	37.322	37.163	37.110	36.689	36.637	36.250	35.804	4.6	-2.8	-3.0
20 Change *	9.4	12.8	19.2	-13.9	-3.5	-9.2	-1.7	-0.6	-4.5	-0.6	-4.2	-4.8			

Note: Except where noted, all data in billions of dollars. Historic sources: BEA, BLS, State of Tennessee

T=Thousands of units, persons, or dollars

* Quarter-to-quarter percent changes expressed at compound annual rates.

A = Actual; E = Forecast

November 25, 2005

Prospects for Tax Revenue: Funding Board Estimates

Table 9

	FY94-95	FY95-96	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	Forecasts FY05-06	FY06-07	FY07-08
1 Total Tax Revenue*	5767.1	6071.7	6415.1	6791.0	7030.3	7558.5	7636.3	7508.6	8505.3	9121.0	9665.6	9921.2		
2 Chg@	4.8	5.3	5.7	5.9	3.5	7.5	1.0	-1.7	13.3	7.2	6.0	2.6		
3 Sales and Use Tax*	3477.0	3673.8	3906.7	4102.7	4337.3	4608.3	4642.7	4654.7	5455.2	5806.5	6094.4	6346.0		
4 Chg@	3.2	5.7	6.3	5.0	5.7	6.2	0.7	0.3	17.2	6.4	5.0	4.1		
5 Income Tax*	101.3	114.5	128.9	160.4	160.6	180.2	198.6	144.5	116.8	139.8	155.4	162.2		
6 Chg@	1.0	13.0	12.6	24.5	0.1	12.2	10.2	-27.2	-19.2	19.7	11.2	4.4		
7 Gross Receipts Tax*	180.6	175.9	189.0	188.4	199.3	213.5	216.8	223.9	216.3	218.6	235.0	238.6		
8 Chg@	9.0	-2.6	7.4	-0.3	5.8	7.1	1.5	3.3	-3.4	1.1	7.5	1.5		
9 Excise plus Franchise Taxes*	777.0	816.1	888.5	913.8	893.4	1074.3	1112.1	968.4	1085.0	1181.9	1367.4	1358.4		
10 Chg@	14.6	5.0	8.9	2.8	-2.2	20.3	3.5	-12.9	12.0	8.9	15.7	-0.7		
11 Gasoline Tax*	528.3	535.9	543.3	563.2	567.9	576.6	569.4	576.9	600.9	600.9	608.1	600.0		
12 Chg@	-4.4	1.4	1.4	3.7	0.8	1.5	-1.3	1.3	4.2	0.0	1.2	-1.3		
13 Vehicle Registration*	179.5	185.2	184.2	196.5	201.5	219.3	212.1	221.2	226.8	240.5	246.3	257.0		
14 Chg@	8.4	3.1	-0.5	6.6	2.6	8.8	-3.3	4.3	2.5	6.0	2.4	4.4		
15 Fuel Tax*	122.2	126.7	126.8	133.2	142.5	152.8	146.8	151.2	154.8	168.8	173.3	174.1		
16 Chg@	9.9	3.7	0.1	5.0	7.0	7.2	-3.9	3.0	2.4	9.0	2.7	0.5		
17 Privilege Tax*	123.8	139.9	150.7	171.0	191.9	186.6	190.1	207.9	248.6	276.9	294.1	295.6		
18 Chg@	-1.4	12.9	7.8	13.4	12.2	-2.8	1.9	9.4	19.6	11.4	6.2	0.5		
19 All Other Taxes*	277.3	303.7	296.8	361.8	335.9	346.9	347.7	359.9	401.0	487.2	491.6	6200.7		
20 Chg@	17.3	9.5	-2.3	21.9	-7.2	3.3	0.2	3.5	11.4	21.5	0.9	1161.3		

Prospects for Tax Revenue: MTSU Forecast

Table 10

Tennessee Economic Assumptions (Fiscal-Year Basis)												Forecasts		
	FY94-95	FY95-96	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	FY06-07	FY07-08
1 Personal Income (Bil \$)	110.0	115.2	121.6	128.9	137.0	144.9	152.0	156.8	162.0	170.4	181.3	189.6	199.9	210.8
2 Chg@	7.7	4.8	5.5	6.0	6.3	5.7	4.9	3.1	3.3	5.2	6.4	4.6	5.4	5.4
3 Nonagricultural Employment (Mil)	2.5	2.5	2.6	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.8	2.8
4 Chg@	3.9	2.2	1.4	2.1	1.9	2.1	0.2	-2.1	0.1	0.5	1.3	0.6	1.1	1.4
5 Income Per Employee (Th \$)	44.6	45.7	47.6	49.4	51.5	53.4	55.9	58.9	60.8	63.6	66.8	69.4	72.4	75.3
6 Chg@	3.7	2.5	4.0	3.8	4.4	3.6	4.8	5.3	3.2	4.7	5.0	4.0	4.3	4.0
7 Retail Sales (Bil \$)	44.5	46.8	48.3	53.5	58.8	62.6	64.1	65.9	67.0	73.1	77.9	83.0	89.2	95.6
8 Chg@	9.3	5.3	3.1	10.8	9.9	6.5	2.4	2.9	1.7	9.1	6.5	6.6	7.4	7.3
9 Building Permits (Th of Units)	27.6	31.3	29.2	29.4	31.2	29.7	26.3	28.0	30.2	36.0	37.3	38.5	36.9	35.7
10 Chg@	-8.2	13.5	-6.8	0.7	6.0	-4.7	-11.3	6.4	8.0	19.0	3.6	3.4	-4.3	-3.3
Revenue Forecasts												Forecasts		
	FY94-95	FY95-96	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	FY06-07	FY07-08
11 Total Tax Revenue*	5,767.1	6,071.7	6,415.1	6,791.0	7,030.3	7,558.5	7,636.3	7,508.6	8,505.3	9,121.0	9,665.6	10,003.2	10,433.6	10,880.6
12 Chg@	4.8	5.3	5.7	5.9	3.5	7.5	1.0	-1.7	13.3	7.2	6.0	3.5	4.3	4.3
13 Sales and Use Tax*	3,477.0	3,673.8	3,906.7	4,102.7	4,337.3	4,608.3	4,642.7	4,654.7	5,455.2	5,806.5	6,094.4	6,359.8	6,649.9	6,952.6
14 Chg@	3.2	5.7	6.3	5.0	5.7	6.2	0.7	0.3	17.2	6.4	5.0	4.4	4.6	4.6
15 Income Tax*	101.3	114.5	128.9	160.4	160.6	180.2	198.6	144.5	116.8	139.8	155.4	162.4	169.4	175.7
16 Chg@	1.0	13.0	12.6	24.5	0.1	12.2	10.2	-27.2	-19.2	19.7	11.2	4.5	4.3	3.7
17 Gross Receipts Tax*	180.6	175.9	189.0	188.4	199.3	213.5	216.8	223.9	216.3	218.6	235.0	243.5	251.8	259.6
18 Chg@	9.0	-2.6	7.4	-0.3	5.8	7.1	1.5	3.3	-3.4	1.1	7.5	3.6	3.4	3.1
19 Excise plus Franchise Taxes*	777.0	816.1	888.5	913.8	893.4	1074.3	1112.1	968.4	1085.0	1181.9	1367.4	1388.6	1444.1	1507.1
20 Chg@	14.6	5.0	8.9	2.8	-2.2	20.3	3.5	-12.9	12.0	8.9	15.7	1.6	4.0	4.4
21 Gasoline Tax*	528.3	535.9	543.3	563.2	567.9	576.6	569.4	576.9	600.9	600.9	608.1	612.5	619.7	628.5
22 Chg@	-4.4	1.4	1.4	3.7	0.8	1.5	-1.3	1.3	4.2	0.0	1.2	0.7	1.2	1.4
23 Vehicle Registration*	179.5	185.2	184.2	196.5	201.5	219.3	212.1	221.2	226.8	240.5	246.3	256.4	263.0	269.3
24 Chg@	8.4	3.1	-0.5	6.6	2.6	8.8	-3.3	4.3	2.5	6.0	2.4	4.1	2.6	2.4
25 Fuel Tax*	122.2	126.7	126.8	133.2	142.5	152.8	146.8	151.2	154.8	168.8	173.3	177.2	183.5	190.8
26 Chg@	9.9	3.7	0.1	5.0	7.0	7.2	-3.9	3.0	2.4	9.0	2.7	2.2	3.6	4.0
27 Privilege Tax*	123.8	139.9	150.7	171.0	191.9	186.6	190.1	207.9	248.6	276.9	294.1	298.7	332.9	362.1
28 Chg@	-1.4	12.9	7.8	13.4	12.2	-2.8	1.9	9.4	19.6	11.4	6.2	1.6	11.4	8.8
29 All Other Taxes*	277.3	303.7	296.8	361.8	335.9	346.9	347.7	359.9	401.0	487.2	491.6	504.1	519.3	534.9
30 Chg@	17.3	9.5	-2.3	21.9	-7.2	3.3	0.2	3.5	11.4	21.5	0.9	2.5	3.0	3.0

* Millions of dollars

@ Annual Percent Change

Annual economic data in lines 1, 3, 5, 7, and 9 are calculated in terms of fiscal years ending in IIQ of the calendar year of the noted fiscal year

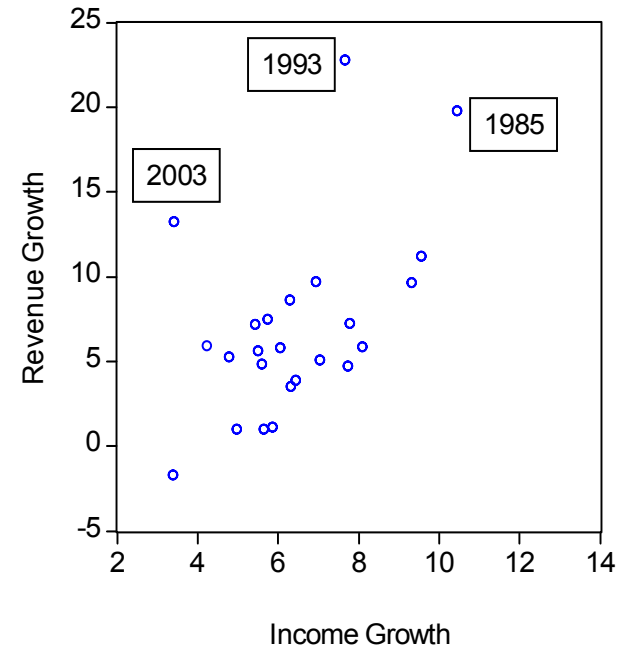
November 27, 2005

A Consistency Check

Top-down forecasting model projects growth in tax revenue based on personal income growth, controlling for tax rate changes in 1985, 1993, and 2003

Based on personal income projections, the consistency check is below

	2006	2007	2008	2009	2010
Revenue Growth	3.4	4.1	4.0	4.0	4.0
Revenue (millions of \$)	\$9,999	\$10,405	\$10,821	\$11,255	\$11,708
Income Growth	4.6	5.4	5.4	5.5	5.5
Employment Growth	0.6	1.1	1.4	1.4	1.4





Contingency Views

Balancing the Risks

Probabilities

- Stronger growth 25%
- Baseline 50%
- Weaker growth 25%

Tilting the balance to weak-growth scenario:

Asymmetric cost of forecast errors

- Lower than projected tax revenue is a bigger problem for the state than higher than projected tax revenue
- *Risk scenario*
 - Faltering U.S. growth with spillover effects to Tennessee
 - Personal income growth in Tennessee is roughly one-half the rate in the baseline forecast
 - Employment growth is roughly one-half the pace projected in the baseline
 - An additional half percent “haircut” to the revenue projection is incorporated to risk case to account reduced elasticity in times of economic stress

Results for this risk scenario, using the consistency model is reported below

	2006	2007	2008
Revenue Growth	2.2	2.5	2.3
Revenue (millions of \$)	\$9,871	\$10,087	\$10,295



The U.S. Outlook – Problem Areas

Monitoring the Likelihood of Weaker Than Projected Growth

Winning the peace

- Uncertainty over the situation in Iraq remains

Global growth

- Growth remains weak outside Pacific rim
- On the positive side, Japan has emerged from its long deflationary recession

Pricing power

- Global capacity continues to limit the ability of manufacturing to secure price increases, which affects ability to manage earnings
- Prices of goods less energy (CPI basis) advanced decline in the past few months
- Effort to hold the line on inflation may again be placing most of the adjustment pressure on the goods-producing sectors

Sector problems

- Housing and vehicle sales supported by low interest rates and some evidence that the bloom is fading
- Defined-benefit pensions remain underfunded and are finally attracting political attention

Energy

- Restoration of natural gas flows could be more of a problem than crude oil flows following Katrina

Interest Rate Cycle and the Yield Curve

- The yield curve is flattening; forecasts of the 1-year and 2-year Treasury yield shows it inverting next summer

The dollar in international currency markets

- Dollar rally may be solely the effect of higher short-term interest rates
- Trade deficit is wide and is unlikely to narrow without a large jump in export growth and a sharp narrowing of import growth
- Private foreign appetite for dollar instruments is weakening
- Capital inflow through official foreign institutions is increasing in importance
- China has adopted a variation of a managed float against a basket of currencies
- China is still heavy purchaser of dollar assets given its sizeable trade surplus with the U.S.